No. 10662

In the United States Circuit Court of Appeals for the Ninth Circuit

Wells Fargo Bank & Union Trust Co., Executor of the Estate of Ben F. Sternheim, Deceased, petitioner

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The Tax Court rendered a memorandum opinion (R. 22–36), which is not officially reported.

JURISDICTION

This petition involves the determination of federal estate tax due from the estate of Ben F. Sternheim, who died April 9, 1940, a resident of San Francisco, California. Petitioner, Wells Fargo Bank & Union Trust Company, is executor of the decedent's estate. (R. 23.) On April 29, 1942, the Commissioner of Internal Revenue mailed to the petitioner as such executor a notice of deficiency in the amount of $48,824.39.

(R. 12–20.) Within 90 days thereafter, on July 2, 1942, the petitioner as such executor filed a petition with the United States Board of Tax Appeals (now The Tax Court of the United States) for a redetermination of the deficiency under the provisions of Section 871 of the Internal Revenue Code. (R. 3–20.) The decision of the Tax Court that there was a deficiency of $16,450.04 was entered on September 3, 1943. (R. 36.) The petition for review by this Court was filed on November 9, 1943 (R. 37–41) under the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

By an instrument dated June 9, 1938, the decedent created a revocable *inter vivos* trust under which, following his death, the income was to be paid to his sister, Blanche M. Sternheim, during her lifetime, with remainder over upon her death to certain charities. The trustee was given the power to invade the principal (up to 10% in any one year) for the benefit of the sister in case of "sickness, accident, want or other emergency."

The question is whether the full value of the remainder is deductible as a gift to charity under Section 812 (d) of the Internal Revenue Code or the deduction must be disallowed to the extent that the corpus could be invaded under the terms of the trust for the benefit of the life beneficiary. The answer depends upon whether the extent to which the corpus (within the 10% limitation) could be diverted was capable of being accurately measured.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(d) [as amended by Section 408 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798 (effective as of February 11, 1939)] *Transfers for Public Charitable, and Religious Uses.*—The amount of all bequests, legacies, devises, or transfers, * * * to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * *. (26 U. S. C. 1940 ed., Sec. 812.)

Treasury Regulations 105, promulgated under the estate tax provisions of the Internal Revenue Code:

SEC. 81.44 *Transfers for public, charitable,*

* * * * *

religious, etc., uses.—

If a trust is created for both a charitable and a private purpose, deduction may be taken of the value of the beneficial interest in favor of the former only insofar as such interest is presently ascertainable, and hence severable from the interest in favor of the private use. * * *

SEC. 81.46. *Conditional bequests.*— * * *

If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is

> subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power.

STATEMENT

The relevant facts as found by the Tax Court (R. 23–26) are substantially as follows:

Prior to his death the decedent, on June 9, 1938, transferred to the Wells Fargo Bank & Union Trust Company of San Francisco, as trustee, policies of insurance on his life in the aggregate amount of $20,000, and savings accounts of approximately $73,000. The income of the trust was to be accumulated and added to principal during the life of the decedent. After his death the income was to be paid to his sister, Blanche M. Sternheim, for life. Upon her death the trust estate was to be divided among the Shriners Hospital for Crippled Children of San Francisco, Mount Zion Hospital, San Francisco, in whatever proportion the trustee in its sole discretion might elect. (R. 23.) The trust agreement contained the following provision (R. 62) authorizing the trustee, in certain circumstances, to invade the trust principal (R. 24):

> 11. The Trustee shall have the power in its uncontrolled discretion to use and apply such part of the principal of the trust estate held for any beneficiary as it may consider suitable or necessary in the interest and for the welfare of such beneficiary in the event of sickness, accident, want, or other emergency of or to any of the beneficiaries then receiving the income from

> the trust estate or from any portion thereof; provided that, except as otherwise herein provided, not more than ten percent (10%) of the principal of the trust estate shall be used or applied in any one year for said purposes of any of them.

The decedent reserved the right to amend, alter, or revoke the trust at any time during his lifetime. (R. 24.)

The value of the trust estate at the date of decedent's death was approximately $97,000. The present value of the assets, which now consist principally of securities, is approximately $87,000. The trust has yielded annual net income since decedent's death of approximately $2,100. All of this income has been paid to the life beneficiary. (R. 24, 94.)

At the date of decedent's death Blanche Sternheim was also the life beneficiary of a trust which she herself established in 1929. The decedent was named trustee of this trust and so served until his death. The assets of the trust have a present value of approximately $138,700. The net income amounts to approximately $7,300 a year. (R. 24, 25, 82.)

At the time of decedent's death Blanche Sternheim was 60 years of age and in sound health. She resides at the Hotel Californian, San Francisco, where her ordinary living expenses amount to about $250 or $300 per month. She regularly saves from $250 to $300 a month out of the income which she receives from the above described trusts. She enjoys good health generally and is economical in her living habits. (R. 25, 97–99.)

After decedent's death it was discovered that he had commingled assets of his own estate and those of the trust created by Blanche Sternheim of which he was trustee. Pending a partition of the commingled assets the income distributions from that trust were suspended and Blanche Sternheim was given an allowance of $500 a month from the corpus of the *inter vivos* trust which decedent had created. This allowance was made by the trustee pursuant to the emergency clause of the trust instrument and upon the agreement of Blanche Sternheim to repay the amounts so withdrawn to the trust. A total of $1,500 was so paid to her and later repaid to the trust. (R. 25, 88–89.)

Thereafter, and at some time not disclosed by the evidence, payments of $500 a month for a period of seven or eight months were made to Blanche Sternheim out of the principal of the *inter vivos* trust while the income distributions from both trusts were suspended pending settlement of an income tax controversy affecting the assets of the trusts. The income-tax controversy referred to involved a transferee liability for income taxes of a corporation known as the Sternheim Company, the stock of which had all been owned by the decedent and Blanche Sternheim. The Commissioner asserted the transferee liability both against Blanche Sternheim and decedent's estate. In final settlement of the matter, and upon the insistence of Blanche Sternheim, the trustee of the *inter vivos* trust, which was also the executor of the decedent's estate, paid to the Collector of Internal Revenue

$8,999.16 out of the principal of the trust in part satisfaction of her transferee liability. (R. 26, 84, 85, 92.)

The Tax Court decided on the basis of its findings (including specifically the evidence of actual invasions of the principal after the decedent's death) that the remainder to the charities was not deductible to the extent of the 10% of the principal each year during the life expectancy of the decedent's sister which was subject to invasion for her benefit. (R. 26–29.)

The Tax Court accordingly determined the deficiency to be $16,450.04 upon the basis of the foregoing holding and certain other items not now in issue.

SUMMARY OF ARGUMENT

The Tax Court was bound as a matter of law, under the applicable regulations and a recent decision of the Supreme Court,[1] to uphold the Commissioner's disallowance of the deduction to the extent that the corpus of the trust was not exempt from invasion. The provisions of the instrument authorizing invasion of the corpus "in the event of sickness, accident, want, or other emergency" introduced factors which, in the language of the Supreme Court, "do not lend themselves to reliable prediction," which are not "capable of being stated in definite terms of money" and which "cannot be accounted for accurately by reliable statistical data and techniques." The Tax Court properly disallowed the deduction to the extent indicated. It is immaterial that the Tax Court may have based its correct decision upon the wrong ground.

[1] *Merchants Bank* v. *Commissioner*, 320 U. S. 256.

ARGUMENT

Since the extent to which the corpus (within the 10% limitation) could be diverted from the charities was not calculable or capable of being stated in definite terms of money, the deduction must be disallowed under section 812 (d) of the Internal Revenue Code to the extent that the corpus is not exempt from invasion under the terms of the trust

The clause of the trust instrument authorizing invasion of the corpus for a noncharitable purpose is as follows (R. 24, 62):

> 11. The Trustee shall have the power in its uncontrolled discretion to use and apply such part of the principal of the trust estate held for any beneficiary as it may consider suitable or necessary in the interest and for the welfare of such beneficiary in the event of sickness, accident, want, or other emergency of or to any of the beneficiaries then receiving the income from the trust estate or from any portion thereof; provided that, except as otherwise herein provided, not more than ten percent (10%) of the principal of the trust estate shall be used or applied in any one year for said purposes or any of them.

Section 81.44 of Treasury Regulations 105, *supra,* permits the deduction in respect to a charitable gift "only insofar as such interest is presently ascertainable." Section 81.46 of Treasury Regulations 105, *supra,* provides that if the gift is subject to diversion in whole or in part to a noncharitable purpose, the deduction "will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power." These regulations were approved by

the Supreme Court in *Merchants Bank* v. *Commissioner,* 320 U. S. 256, 260:

> These Regulations are appropriate implementations of § 303 (a) (3) [now Section 812 (d)], and, having been in effect under successive reenactments of that provision, define the framework of the inquiry in cases of this sort.

The corpus of the trust in the instant case is clearly not exempt from diversion within the meaning of Section 81.46 of the regulations to the extent of 10% thereof each year during the lifetime of the decedent's sister.

In the *Merchants Bank* case, decided by the Supreme Court on November 15, 1943 (after the decision of the Tax Court in the instant case) the will authorized invasion of the corpus (p. 258) "for the comfort, support, maintenance and/or happiness of my said wife." Evidence was presented by the taxpayer as to the wife's modest mode of life and her substantial resources within and without the trust, evidence similar to that offered on behalf of the taxpayer in the instant case. The Tax Court (then the Board of Tax Appeals) had held on the basis of this evidence, following the language of *Ithaca Trust Co.* v. *United States*, 279 U. S. 151, that the charitable remainder was affected by "no uncertaintly * * * appreciably greater than the general uncertainty that attends human affairs," and had accordingly allowed the deduction in full. *Estate of Field* v. *Commissioner,* 45 B. T. A. 270, 273. The decision of the Tax Court was reversed by the Circuit Court of Appeals for the First Circuit *sub nom. Commissioner* v. *Mer-*

chants Nat. Bank of Boston, 132 F. 2d 483, and certiorari was granted by the Supreme Court.

The Supreme Court looks to the will for the answer to the question whether the extent to which the corpus is subject to diversion can be measured accurately, and lays down the rule to be followed in such cases as follows (320 U. S. at p. 261):

> For a deduction under § 303 (a) (3) to be allowed, Congress and the Treasury require that a highly reliable appraisal of the amount the charity will receive be available, and made, at the death of the testator. * * * Only where the conditions on which the extent of invasion of the corpus depends are fixed by reference to some readily ascertainable and reliably predictable facts do the amounts which will be diverted from the charity and the present value of the bequest become adequately measurable. And, in these cases, the taxpayer has the burden of establishing that the amounts which will either be spent by the private beneficiary or reach the charity are thus accurately calculable.

The Court distinguishes the *Ithaca Trust* case where diversion for the widow's benefit was authorized (p. 154) to the extent necessary "to suitably maintain her in as much comfort as she now enjoys," on the ground that the diversion there was subject to "a fixed standard based on the widow's prior way of life" (p. 261).

Under the rule of the *Merchants Bank* case it is no longer open to the court, except where reference is made to a fixed objective standard, to determine on the basis of extrinsic evidence, as suggested in the *Ithaca Trust* case, that the charitable gifts are affected by

"no uncertainty * * * appreciably greater than the general uncertainty that attends human affairs." The deduction must be disallowed to the extent that the charitable gift is not exempt from diversion to a noncharitable purpose. The remoteness or unlikelihood of such diversion is immaterial.[2]

In the instant case diversion is authorized for the benefit of the decedent's sister "in the event of sickness, accident, want, or other emergency." (R. 24). No reference is made to the sister's existing way of life or to any other objective standard. Invasion of the corpus is not restricted to purposes of "maintenance and support." Cf. *Lucas* v. *Merchantile Trust Co.,* 43 F. 2d 39 (C. C. A. 8th); *First Nat. Bank* v. *Snead,* 24 F. 2d 186 (C. C. A. 5th); and *Hartford-Connecticut Trust Co.* v. *Eaton,* 36 F. 2d 710 (C. C. A. 2d). The decedent apparently considered that his sister would have ample means for maintenance and support according to her accustomed standard, the income of the trust and her other resources being more than sufficient for this purpose.

It was the unforeseen casualty which the decedent had in mind, a prolonged illness, a disabling accident, contingencies which cannot be anticipated. The inclusion of "other emergencies" practically eliminates all check upon the trustee and makes possible the invasion of the corpus in case of financial need or embarrassment on the part of the beneficiary, whatever

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[2] The application of this rule is also involved in *Commissioner* v. *Wells Fargo Bank & Trust Co.* (Mary A. Hume Estate), pending in this Court, docket No. 10649, decided by the Tax Court prior to the *Merchants Bank* decision.

the cause. The Century Dictionary defines "emergency" as "a sudden or unexpected happening; an unforeseen occurrence or condition * * * something not calculated upon." The amounts which might be diverted under this provision to the decedent's sister out of the corpus of this trust obviously could not be measured or calculated or even estimated in advance. The nature and unforeseeability of the contingencies upon which invasion of the corpus was made to depend are further emphasized by counsel for the taxpayer in their brief referring to the occasions which gave rise to the invasion of the corpus (p. 14):

> The action of the trustee of the Blanche Sternheim trust in withholding income had no relation to the circumstances existing at the date of death and certainly was hardly within the realm of reasonable anticipation at that time. In other words, these payments were purely accidental.

Opposing counsel assert that the contingencies which gave rise to the payments actually made could not have been foreseen in advance, thereby in effect conceding the critical point at issue, that the instrument is to be construed as authorizing the invasion of the corpus upon unforeseeable contingencies.

Before the *Merchants Bank* decision was rendered by the Supreme Court, this Court had decided *Commissioner* v. *Bank of America, etc.,* 133 F. 2d 753, 755, where invasion of the corpus was authorized in case of "accident, illness or other unusual circumstances." The Court referred to the decision of the Circuit Court of Appeals for the First Circuit in the *Merchants*

Bank case, 132 F. 2d 483, as supporting the Commissioner's view that the mere possibility of invasion of the corpus was sufficient to defeat the deduction. This Court indicated that the *Merchants Bank* case might "perhaps" be distinguished on its facts from the case then before the court. Conceivably there is a distinction between the authority to invade the corpus for the "happiness" of the life tenant (as in the *Merchants Bank* case) which would require the application of a subjective test, and the authority to divert in the event of "sickness, accident, want, or other emergency," occurrences or conditions which are presumably objective. But for purposes of applying the rule of the *Merchants Bank* case, it is submitted, there is no distinction.[3] In either case the basis for the invasion of the corpus is not to be foreseen in advance and the extent to which the corpus may be invaded cannot therefore be calculated.[4]

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[3] In *Henricksen* v. *Baker-Boyer Nat. Bank.*, 139 F. 2d 877, rehearing denied March 17, 1944, this Court stated the issue in terms of the *Merchants Bank* case.

[4] It may be noted in passing (and entirely apart from the rule in the *Merchants Bank* case) that the *Bank of America* case is distinguishable on its facts from the instant case. There the beneficiary was given an annuity of $250 per month, substantially less than the entire income of the trust; an excess fund of some $4,000 had accumulated in the income account during a period of four years and was available to the life beneficiary in case of need before any invasion of the principal could take place. This is similar to the case of *Commissioner* v. *F. G. Bonfils Trust*, 115 F. 2d 788 (C. C. A. 10th), where the charitable deduction was also allowed. The instant case presents an entirely different situation. The entire income is paid out periodically to the life beneficiary, no reserve is accumulated, and the only fund available for increased payments to the life beneficiary is the principal itself.

Under the plain language of the regulations and the rule of the *Merchants Bank* case, the Tax Court was required as a matter of law to disallow the deduction to the extent that the corpus of the trust was not exempt from invasion for the benefit of the decedent's sister.

The petitioners do not mention the decision in the *Merchants Bank* case. Instead, they base their whole argument on the assumption that whether or not the full value of the remainder may be deducted as a bequest to charity turns upon the probability of invasion of the principal of the trust, arguing on the basis of the *Ithaca Trust* case that that probability must be determined exclusively by circumstances prevailing at the date of the decedent's death, and that the Tax Court erred in relying on circumstances occurring subsequent thereto as a basis for its determination that the probability of invasion was not so remote as not to affect the gift to the charity.

The decision of the Tax Court in this case was rendered some months before the decision in the *Merchants Bank* case, and the Tax Court felt itself bound by the language of the opinion in *Ithaca Trust Co.* v. *United States, supra*, to determine as a matter of fact whether the remainder was likely to be invaded. In doing so it considered the instrument itself, the evidence of the life beneficiary's outside resources, her health and way of life and evidence that on three separate occasions after the decedent's death there had been actual invasions of the corpus, and reached the conclusion that the deduction should be disallowed

to the extent of 10% of the principal each year during the life expectancy of the sister, that being the maximum amount by which the corpus could be diverted. Under the *Merchants Bank* decision the disallowance of that amount was required, not by virtue of the fact that probabilities of invasion were not negligible but because no standard for invasion had been fixed which could be measured in terms of money. The decision of the Tax Court was therefore correct though it gave the wrong reason.

If, however, as the petitioners erroneously assume, the probability of invasion were the controlling factor, we think that it was not error for the Tax Court to consider evidence showing that on three separate occasions after the decedent's death there had been actual invasions of the corpus, for the reason that this evidence showed how the parties themselves construed the trust.[5] On two occasions allowances of $500 per month were paid to the decedent's sister out of the principal of the trust during periods while her other income was temporarily cut off. (R. 25, 26, 88, 89, 92.) The aggregate of such payments was $5,200. On a third occasion approximately $9,000 was paid out of principal upon the insistence of the sister in partial settlement of her individual income-tax liability. (R. 26, 84–85.) The likelihood of invasion depended in part on whether the language of the emergency clause was to be liberally or narrowly construed. The parties

[5] The contemporaneous and practical construction given to an instrument by the parties is strong evidence of its meaning. *Bell* v. *Staake*, 141 Cal. 186, 201; *Miller* v. *Security-First Nat. Bk. of L. A.*, 219 Cal. 120; *In re Leupp*, 108 N. J. Eq. 49.

by their practical construction have given the answer.[6] An "emergency" is any event affecting the income of the life beneficiary or any financial obligation of the life beneficiary however arising.[7]

If the allowance of the deduction had depended upon the likelihood of invasion such evidence should properly have been considered, and the finding of the Tax Court that the probability of invasion was not so remote as not to affect the value of the charitable gift would, if material, be conclusive upon this Court. But these questions are moot, in view of the decision in the *Merchants Bank* case. It is not necessary to look beyond the terms of the trust instrument itself to decide whether or not a standard for invasion was prescribed which was susceptible of being measured in terms of money. What would be required for the use of the life beneficiary in the event of sickness, accident, want or other emergency is clearly just as unpredictable in this case as what would be required for

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[6] The actions of the parties are significant also as placing the taxpayer in an inconsistent position. The taxpayer, while contending that the language of the emergency clause is so limited in scope that it may be eliminated from practical consideration, insists that its actions as trustee and those of the life tenant (the party beneficially interested) tending to support a most liberal construction should not have been considered by the Tax Court. Compare *Widney* v. *S. Pacific Co.*, 120 Cal. App. 241; *Malinow* v. *Dorenbaum*, 51 Cal. App. 2d 645; *Miller* v. *Security-First Nat. Bk. of L. A.*, *supra.*

[7] The practical construction of the instrument adopted by the trustee was particularly significant since the remaindermen, the charities, were not in a position to object individually to the actions of the trustee, the share of the corpus to be allocated to each of the three charities depending upon the sole, uncontrolled and absolute discretion of the trustee. (R. 61–62.)

the "happiness" of the life tenant in the *Merchants Bank* case. Since there is no standard except the 10% limitation which can be measured in terms of money the deduction must be limited to the amount which is exempt under the instrument from the power of diversion.

It is well settled that the decision of the Tax Court must be affirmed if it is right for any reason. *Helvering* v. *Gowran,* 302 U. S. 238. It is therefore immaterial that the Tax Court based its decision on the wrong reason or, if such was the case, that it considered evidence that was not material. The error, if any, was harmless error. The Tax Court found all of the facts which are necessary for this Court to decide the issue of law here involved on the basis of correct principles as established by the *Merchants Bank* case. The decision of the Tax Court was correct, though based on an erroneous reason, and should be affirmed.

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

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